THE GOLD STANDARD

Four By Five

Gary Allen *is author of* None Dare Call It Conspiracy; The Rockefeller File; Kissinger; Jimmy Carter/Jimmy Carter; Tax Target: Washington; *and,* Ted Kennedy: In Over His Head. *He is an* AMERICAN OPINION *Contributing Editor.*

■ UNTIL RECENTLY the idea of returning to some type of gold standard had as much intellectual credibility with the Establishment as do the notions of the Flat Earth Society. Mainstream journals treated the topic with stony silence or utter disdain. Yet today almost every news and financial publication has carried articles about the gold standard. We would estimate that they are about eighty percent positive. The snide cracks about gold being a "barbarous relic" are gone. Apparently the *Insiders* of international finance are in the process of switching their position on gold.

This is not because they are getting "religion," but because they prefer to ride the tides of profit rather

In ten years the money supply is up 186 percent. Prices have soared 137 percent. The prime rate has jumped 271 percent. And savings are down 37 percent while real wages have dropped 14 percent. The dollar, in short, is on the ropes. The question is whether a 100 percent gold standard is the permanent answer.

than swim against them. During the last century the name of the game in Europe was to inflate during wars by abandoning the gold standard, and then with the conclusion of hostilities to revert back to gold and cash in for hard money the bonds they purchased with paper. It was a profitable game. Following World War I they switched to the even more profitable game of paper manipulation. Because of public outrage the inflation game is about over — and the *Insiders* know it. So it is time to switch strategies.

While the new U.S. Gold Commission debates the pros and cons of a gold standard, we expect one more last hurrah for worldwide inflation. During this period the *Insiders* will try to gobble up the savings and loans; the insurance companies; and, debt-ridden and over-extended manufacturing firms. Then, in the midst of a worldwide inflationary depression, they will move to restore some kind of gold standard. Bonds which were purchased for pennies at huge discounts during the inflationary blowoff will be redeemed in gold as interest rates stabilize at four percent or so.

The main reason for renewed popular interest in gold as a feature of monetary reform is the disastrous record of the last ten years under an unbacked and politically managed paper dollar. Economists are comparing the gold coins of the Byzantine civilization, which served successfully as the monetary standard of the known world for over eight hundred years, to the instability of the paper American dollar over the past ten years. The money supply is up 186 percent. Prices have soared 137 percent. The prime interest rate has jumped 271 percent. Bankruptcies are up 77 percent since 1971. Meanwhile, savings are down 37 percent and real wages are down 14 percent. The dollar is clearly on the ropes.

One solution being offered is the "monetarist" approach of Professor Milton Friedman — the Nobel laureate and co-author of the best-selling book *Free To Choose*. The Friedman plan calls for staying with our present system of unbacked currency but limiting the increase in its quantity to some fixed rate between three and five percent per year.* If this proposal were implemented the pernicious system of legal counterfeiting would continue — but at a limited rate.

Aside from the problem of how the inflation rate would be brought down to three to five percent without precipitating a politically disas-

*A *Program For Monetary Stability* (Chicago: University of Chicago Press, 1956).

Gamma — Marie-Laure de Decker

With the American government deprived of its monopoly over money, competition in currencies would lead to the voluntary adoption of a market gold standard which would protect money value. It would also serve to remove the political props which now support the inflationary system of fractional-reserve banking.

trous depression, there is the question of whether the money controllers could be made to abide by fixed restrictions on monetary growth. Who could be trusted to limit the rate at which fiat money would be created?

Professor Friedman has been an outspoken critic of the Keynesian orthodoxy, but he does not challenge the notion that money must be under the control of a political monopoly. History demonstrates that giving a monopoly over the creation of money to either government or a politically privileged clique of bankers is like putting a dope addict in charge of the drug cabinet. As Professor Hans Sennholz observes in his important book *Age Of Inflation* (Boston: Western Islands, 1979):

"Even if the System had been managed by the greatest financial minds of the century, its very premise of central management of money and credit is alien to economic freedom and contrary to economic and social stability. The very existence of a money monopoly that endows its fiat issues with legal-tender standing is antithetic to individual choice and freedom. By its very nature as a central bank it must seek to place currency in the loan markets, or withdraw it, in order to manage and manipulate those markets. But we are convinced that neither the addition nor the reduction of fiat money imparts any social utility, which leads us to conclude that Federal Reserve policies necessarily are disruptive to monetary stability. In particular, its frequent bursts of currency expansion, so popular with government officials, politicians, and their beneficiaries, have given our age the characteristics of unprecedented monetary instability."

Indeed, it was Milton Friedman who with Anna Schwartz demonstrated empirically that there has been a great deal more instability since the creation of the Federal Reserve than during the half century preceding.* Nonetheless, the monetarists still pooh-pooh any sort of gold standard and continue to uphold the system of institutionalizing counterfeiting under monopoly control.

Even when a nation starts out with a gold-backed currency, if that currency is under monopoly control, the tendency is toward the gradual abandonment of gold backing, leading ultimately to an irredeemable currency. Professor Friedman knows very well that whatever government touches turns to fertilizer. It is no different when it comes to money. Government

*Milton Friedman and Anna Schwartz, *Monetary History Of The United States: 1867-1960* (Princeton: Princeton University Press, 1963).

control over money invariably leads to its corruption and debasement.

The opposite of monopoly is competition. Which brings us to a better proposal for rescuing our money system and ending inflation — a solution which abandons the present politically supported monopoly over money. This is the position put forth by the "Austrian School" of Free Market economics represented by the late Ludwig von Mises* and his admirers, including Henry Hazlitt, Hans Sennholz, Percy Greaves, Murray Rothbard, George Reisman, and Friedrich A. Hayek. These economists propose an end to the government's monopolies in the field of money and banking in order to permit Free Market competition among privately issued currencies. This would mean the elimination of all legal-tender laws and of government regulation over currency issuers, requiring only that each private trademark be protected against forgery.

One relatively recent version of such a system is described in two booklets by Nobel laureate F.A. Hayek. They are *Choice In Currency* and *Denationalization Of Money*, published by the London Institute of Economic Affairs in 1976. Professor Hayek maintains: "This monopoly of government [*over money*], like the postal monopoly, has its origin not in any benefit it secures for the people, but solely in the desire to enhance the coercive powers of government . . . . All history contradicts the belief that governments have given us a safer money than we would have had without their claiming an exclusive right to issue it."

Under our present system the growth in the money supply is linked to debt, especially the burgeoning government Debt. A private-enterprise money system would break that link. As Hayek observes, "If we are to preserve a functioning market economy (and with it individual freedom), nothing can be more urgent than that we dissolve the unholy marriage between monetary and fiscal policy." This would mean the abolition of the Federal Reserve paper factory and the abandonment of the Keynesian rationale for deficit spending. It would put an end to our debt-reserve system of central banking and stop inflation.

The ultimate solution to the inflation problem would be Separation of Money and State, for the same reason as the separation of Church and State — to prevent any group from using the political power of Big Government to gain monopoly and special privilege at the expense of everybody else. This would destroy the stranglehold of the Establishment *Insiders* by ending the Money Trust and its manipulations. And, with the abolition of central banking, our economy would at last be freed from the traumatic and unnecessary swings of boom and bust. That is what the Austrian School economists — followers of Mises — are proposing.

What kind of money would emerge from Free Market competition? The Mises-influenced economists, except for Hayek, predict that a gold money system would

(*Continued on page ninety-five.*)

*Ludwig von Mises, the great fountainhead of modern economic wisdom, was an uncompromising champion of the ideals of freedom and Free Enterprise. His most important works include *The Theory Of Money And Credit*, *Socialism*, and his magnificent *Human Action*. These are not for beginners, however, and the new student should begin with such Mises books as *Planning For Freedom*, *Planned Chaos*, and *Bureaucracy*, or with some basic introductory text such as *Free Market Economics* by Bettina B. Greaves. Mises served on the Editorial Advisory Committee of AMERICAN OPINION from its founding until his death in 1973 at the age of ninety-two.

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arise. Unlike his "Austrian School" colleagues, however, Professor Hayek believes that privately issued paper would win out over gold and silver in this competition. In *Denationalization Of Money* he expresses his belief that those who issue private currency "will limit the quantity of their paper issue and thus maintain its value." In the last chapter of his excellent book *The Inflation Crisis, And How To Resolve It* (Arlington House, 1978), Henry Hazlitt criticizes this view, observing:

"I confess myself unable to follow the assumptions behind Hayek's currency proposal. A long-established government money has an established purchasing power, even though additional paper-money issues reduce it. But how does a private issuer establish the value of his money unit in the first place? Why would anybody take it? Who would accept his certificates for their own goods or services? And at what rate? Against *what* would the private banker issue his money? With *what* would the would-be user buy it from him? Into *what* would the issuer keep it constantly convertible? These are the essential questions."

Clearly, Free Market competition in money would not result in the acceptance and use of a privately issued irredeemable currency, but rather in its abandonment for gold and silver or claims to them. As Robert Welch has observed, what is needed is a "gold-backed, fully redeemable, *unmanaged* currency."

Unlike fiat currency, gold does not need to be politically managed. Because it cannot be created without limit or at whim, gold money does not have to be a monopoly privilege of anyone to retain its value. Anyone could be allowed to mint gold and silver coins and use them as money. Nor does gold have to be given value artificially through legal-tender laws. It is market-chosen money, not politically imposed money. In a free market, good money (gold and silver, or currency redeemable in gold or silver) would drive out bad money. This is Gresham's Law in reverse.* It is merely a specific case of the well-known wider tendency in a Free Market for good products and services to displace inferior ones.

With the government constitutionally restricted to a policy of *laissez faire* in the crucial area of money and banking, competition in currencies would, we believe, lead to the voluntary adoption of a market gold standard. It would also remove the political props which now undergird the inflationary system of fractional-reserve banking.† Because of competition among banks, there would be natural limitations on how much money a bank could lend beyond its hard reserves. If a bank overextended itself, and did not have enough reserves to back its checks, it would quickly go bankrupt as other banks called on it for redemption in real money.

Another check against fractional reserving under private enterprise is the phenomenon of the "bank run" in which those over-extended banks which cannot pay out the money they

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*Gresham's Law ("Bad money drives out good money") comes into play only when government intervenes artificially to favor one commodity over others as money. This is done through legal-tender laws, or by imposing a fixed exchange ratio between two or more commodities serving as money. In the absence of such political intrusions, good money drives out bad money — the opposite of Gresham's Law.

†Fractional-reserve banking is the system in which more paper notes and credit are issued than there are assets to back them.

are supposed to have on deposit go bankrupt and face lawsuits or an angry mob. Government intervention has neutralized this check on bank credit expansion by, in effect, putting a penny in the fuse box. If banks get into this trouble now, the Treasury can declare selective bank holidays — freezing the assets to prevent them from being removed by nervous depositors. The Federal Deposit Insurance Corporation and the Federal Reserve stand ready as the lenders of last resort to inflate the money supply to Perdition in order to bail out the system and pay off all depositors with cheap money in case of a national banking crisis. This means that the corrective period of liquidation need never come, and hyperinflation is now free to occur without limit — until the market in dollars totally collapses and barter replaces fiat money. Under Free Market banking, there would be no F.D.I.C., and unsound banks would be permitted to fold rather than be subsidized as they are now.

While occasional *local* bank failures could occur, they could not pull the entire nation into a widespread and devastating panic and depression as can and does occur when banks are yoked together under central banking. Under Free Market banking, the banks would be like dominos that are set too far apart to have a chain reaction if one should fall. Private insurance of depositors would of course be available, and might even become a feature of inter-bank competition subject to market-directed business practice.

There is a division of opinion within the hard-money ranks concerning fractional-reserve banking. Some maintain that it is inherently fraudulent and should be made illegal.* After all, the argument goes, is there any essential difference between the practice of fractional-reserve banking and the act of an embezzler who "borrows" (steals) some of his clients' money to gamble on the stock market or the horse races, hoping to have it all back by the time the bank examiner comes to check the books? If the embezzler loses the money through his gambling, or if the bank examiner comes unexpectedly early, he is caught and goes to jail. But, whether he is actually caught, he is still a crook.

It is argued that a bank's notes are supposed to be receipts for real goods on deposit. Even if the bank's customers don't all try to redeem their receipts at the same time, if the real money is not there backing up every note, then the bank is in fact defrauding its clients. Since fraud is an indirect form of coercion in violation of property rights, and since it is the proper function of government to protect our rights to our property from such violation, these hard-money advocates advise that fractional reserving should be outlawed like any other case of fraud or embezzlement.

They would require banks, like all other firms, to honor their contractual obligations by always having enough real money (gold or silver specie) on hand to redeem all their demand receipts. That is, they would be barred from lending funds out of demand deposits (checking accounts) that their depositors are entitled to withdraw at any time on demand. In this view, the *exemption* of banks from the law protecting contracts is

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*This is the position taken by Professor Murray Rothbard, who has for twenty years been advocating Free Market money and banking (albeit with a legal ban on fractional reserving). See his "The Case For A 100 Percent Gold Dollar," *In Search Of A Monetary Constitution*, Leland B. Yeager, editor (Cambridge: Harvard University Press, 1962).

itself a form of government intervention in the way of a special privilege, the right to counterfeit through credit.*

Others point out that banks could be permitted to engage in fractional-reserve operations if they did so clearly and openly, explaining to their customers that their notes are not fully backed. This way, people who chose to patronize fractional-reserve banks would do so at their own risk. This was Mises' position, which he shared with the French economist Henri Cernuschi.†

Whether fractional-reserve banking were made illegal or not, however, the severe limitations on it in a Free Market banking system could make the practice virtually nonexistent. Dr. George Reisman, Associate Professor of Economics at Pepperdine University in Los Angeles, explains what he believes would happen in the absence of government encouragements of the practice:

"Fractional-reserve banking on the part of the commercial banks is a major part of the inflation process. I believe that the ability of the commercial banks to create money is itself indirectly a product of government intervention. I may not be able to show that this is one hundred percent true, but I think it's very largely the case. First of all, in order for the commercial banks to create any additional money beyond a certain point, they must have additional reserves. The only place they obtain these additional reserves is from the government. The government has also done everything in its power over many generations to make it possible for the commercial banks to operate with lower and lower reserves. Before the Civil War, every bank issued its own banknotes, and there was no federally issued paper money at all. The popular complaint was that there were thousands of different paper monies, and no one except an expert could tell which ones were up to par. So, paper money could not be as widely acceptable in that kind of environment. The only kind of money that *was* generally acceptable was gold or silver. Well, when the government began issuing its own paper money, this greatly increased the acceptability of paper money. This made it possible to reduce the role of the precious metals in the system.

"The government also intervened throughout our history by allowing banks to suspend payments of specie whenever they ran into difficulty. That permitted a greater growth of fractional-reserve banking. The government took over the obligation of examining the banks and assuring their safety. If the government had not intervened in banking at all — if it had done nothing to *promote* frac-

*When we speak of a one hundred percent reserve system, we are referring only to demand deposit accounts — not time and savings deposit accounts. The depositor of demand deposits does not lend his funds to the bank, and he rightfully expects the bank to keep his funds on hand until he demands them by his check. He does not expect the bank to lend these same funds to somebody else — as is the common practice in commercial banking today. On the other hand, a depositor who places his wealth in a time or savings account *does* expect the bank to lend these funds to earn interest for him and profit for the bank or lending institution. When he sets up such a savings account, he agrees to the bank's rules and regulations regarding limitations on withdrawals (in terms of prior notice, penalties for early withdrawals, *etc.*). Consequently, it is not expected nor necessary for the banks to have any reserves for savings accounts.

†See Mises, *Human Action* (New Haven: Yale University Press, 1949), Pages 439ff and 443. See also *The Freeman* (Irvington-on-Hudson: Foundation for Economic Education), September 1981, Pages 518-519. Actually, private coinage and Free Market banking were being advocated as far back as the Nineteenth Century. See William Brough, *Open Mints And Free Banking* (New York: Putnam, 1898).

tional-reserve banking — I for one doubt that the system could ever have been very significant. So, I would credit that inflation for which fractional-reserve banking is responsible to government intervention. And I would say that, in the process of achieving sound monetary conditions, it would be legitimate for the government to impose on the commercial banks a one hundred percent reserve requirement against demand deposits."

It must be emphasized that, under Reisman's plan, the one hundred percent reserve requirement would be imposed only during the brief transition period to a gold-coin money system — which would be in the hands of the people (rather than the gold being hoarded by the government in Fort Knox). After that, the government would have nothing to say about banking, and the extent of fractional-reserve banking would be determined solely by the competitive marketplace.

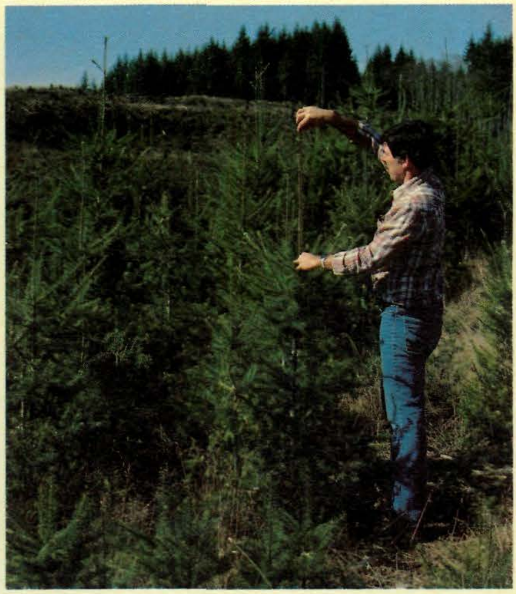
It is important to remember that, in accordance with the Mises explanation for cycles of boom and bust, credit expansion from fractional-reserve operations — when made possible by government in the past — has resulted in unsettling credit crunches. Professor Reisman explains:

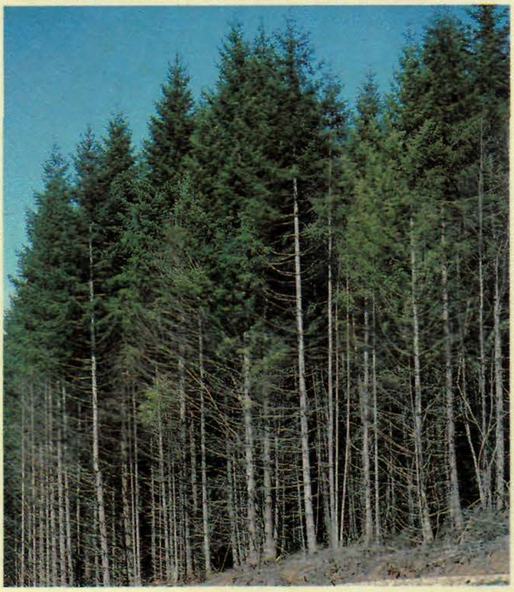
"There's a major fallacy which holds that if the banking system creates money and lends it out, they're doing the equivalent of creating new and additional capital. Imagine that I print a million dollars, I lend it to you, and you build a factory. There are people who think that we are increasing the supply of factories in the economy. The fact is, when you get a million additional dollars, you are going to start bringing about some rise in the prices of raw materials, of wage rates, and so forth. Now what happens to the adequacy of the money capital of *other* people, who haven't received new and additional money, but who find that with their present capital they have to pay higher wage rates and higher materials prices? They suddenly find they need more capital to do business."

Those firms which needed more capital funds could be helped with *further* credit expansion. But when this credit inflation had to stop, as it always did in the fractional-reserve gold standard of the Nineteenth Century, many firms could not get enough money to continue operating. In other words, credit expansion leads to a credit crunch under a fractional-reserve gold system.

As Reisman summarizes, "All of the financial contractions [*of the Nineteenth and early Twentieth Century*] were the result of processes of *limited* inflations that came to an end. The limited inflation artificially reduced the need and desire to own money balances, boosted the velocity of circulation, as well as creating additional money. And then, when the process stopped, the velocity of circulation fell, and when debtors couldn't repay bank debts, banks failed and the quantity of money was actually reduced . . . . The panics before the Federal Reserve were the result of fractional-reserve banking. The Federal Reserve is an extension of that system. The only difference is that today the Federal Reserve goes on with expansion without limit. There are now no serious halts to the process of expansion."

The fractional-reserve system did indeed tend systematically to bring about cycles of boom and slump. Such reactions to credit expansion (1819-1820, 1839-1843, 1857-1860, 1873-1878, 1893-1897) were, however, shorter and much milder than the depressions (1920-1921, 1929-1933,





and 1973-1975) we have experienced since establishment of the Federal Reserve and its greater credit inflation policies.

Under the increasingly government-controlled gold standard, observed Henry Hazlitt, "there is a constant political pressure to reduce interest rates or the reserve requirement so that credit expansion — inflation — may be encouraged or continued. It is supposed to be the great advantage of a fractional-reserve system that it allows credit expansion. But what is overlooked is that, no matter how low the required legal reserve is set, there must eventually come a point when the permissible legal credit expansion has been reached. There is then inevitable political pressure to reduce the percentage of required reserves still further."

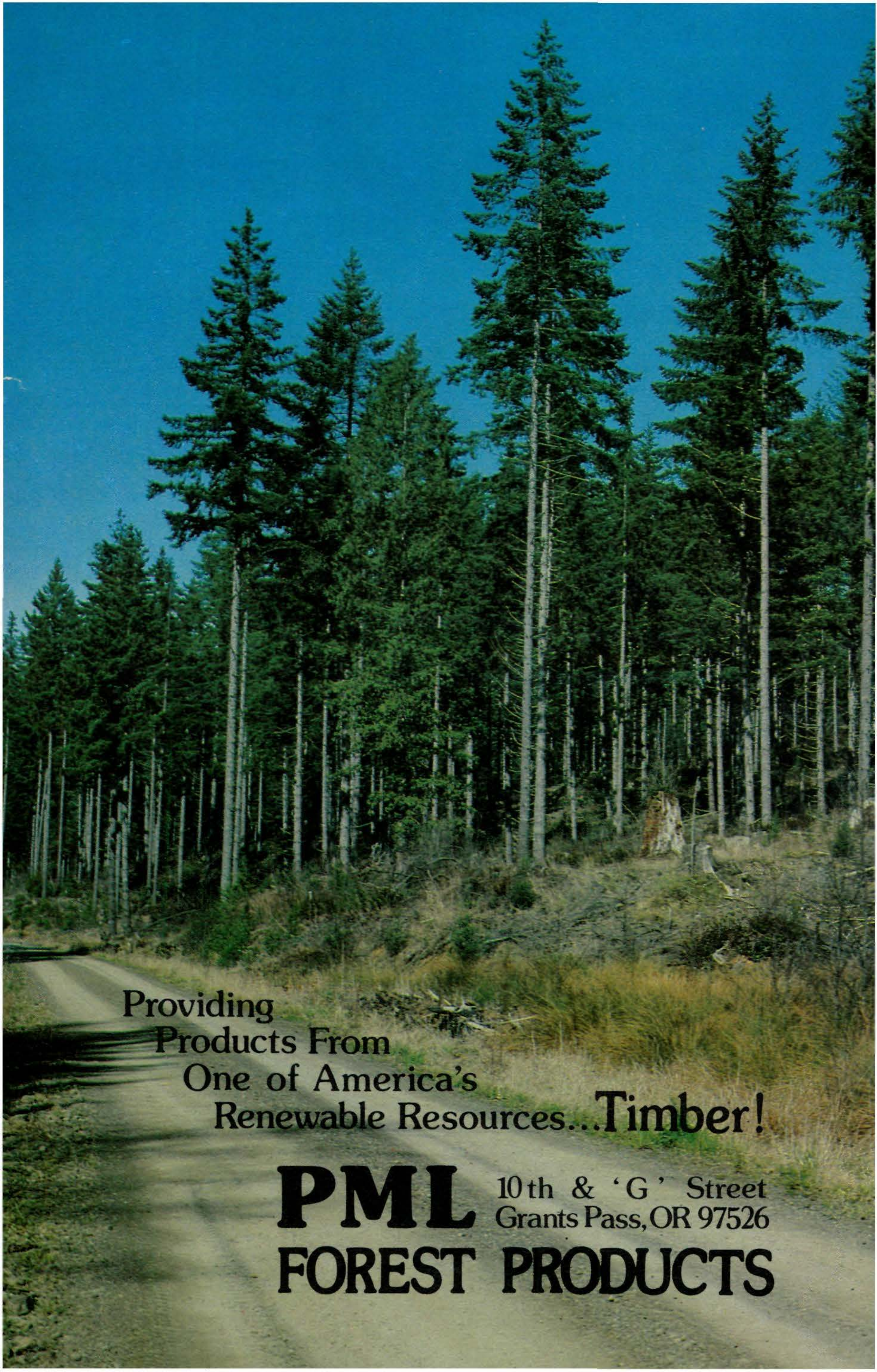
This is exactly what happened to the classical gold standard. More and more paper was allowed to pyramid on top of gold and silver. The creation in 1913 of America's third national central bank — the Federal Reserve System — was the beginning of the end of the gold standard. The U.S. abandoned the classical gold standard in World War I and never returned to it. Instead, the U.S. and most other major nations adopted the *gold-exchange* standard, in which the U.S. dollar and the British pound served as reserve assets on an equal footing with gold for the other currencies, and the dollar and the pound would supposedly be backed by gold for settling international account balances. But a gold-exchange standard is not the same thing as a gold standard. It was a very important step in the plans of conspiratorial *Insiders* to substitute a paper money and debt system for the old gold standard. They needed a system they could more easily manipulate.

The gold-exchange standard had its roots in Resolution Nine of the 1922 Genoa Conference. Presented under the guise of "improving" the world's monetary situation, the Conference had as its primary purpose the phasing out of gold from the world's monetary scene. Striving for the establishment of a "new world order," the organizers of this "reform" were members of the conspiratorial Round Table — the mother organization for both the Royal Institute of International Affairs in England and the Council on Foreign Relations in the United States.*

Eventually, only the dollar was retained as the world's reserve currency. But, of course, the dollar was not as good as gold. The infamous Bretton Woods agreement of 1944 — at which Communist agent Harry Dexter White and Fabian John Maynard Keynes organized the creation of the International Monetary Fund — simply extended the gold-exchange (dollar reserve) system after World War II. The I.M.F. is like a world Federal Reserve, and the dollar is the world currency to which all other currencies are linked; thus, the I.M.F. is the engine of world inflation since the dollar is no longer anchored in any way to gold.

Laying the groundwork for all of this, the Congress had in 1933 declared Federal Reserve notes to be

*Less than a decade later, the Chatham House Study Group of the R.I.I.A. (the "front door" of the Round Table) assembled another conference on money. In a prominent paper delivered at that confab, banker Sir Otto Niemeyer stated: "I therefore feel very strongly that it is very important to establish a general view that a gold coin in internal circulation is not a sign of good form or of advanced economic conditions, but just the opposite — it is the sign of almost medieval decadence." (Royal Institute of International Affairs, *The International Gold Problem*, London: Oxford Press, 1931, Page 86.)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legal tender (they had previously been only money substitutes, redeemable in gold or silver), and declared gold coins, which were formerly legal tender, to be illegal as money. In 1934 American citizens were prohibited from owning gold. This was the end of the domestic gold standard, or what was left of it.

Franklin Roosevelt devalued the dollar from twenty dollars per ounce of gold to thirty-five dollars per ounce, *after* having stolen the peoples' gold a few weeks earlier. It was a perfidious act of outright theft, but was excused as being essential to economic recovery. By the late 1960s, because of its Keynesian inflationary policies, the U.S. Government could no longer redeem its foreign-dollar claims at the official price of thirty-five dollars an ounce. Finally, on August 15, 1971, President Richard Nixon — refusing to devalue the dollar openly — closed the gold window when he suspended redeemability to foreigners.

Under the old gold standard, world currencies were defined in terms of a specific weight of gold and, consequently, could be traded at fixed exchange ratios to one another. Now, the international money system is in chaos, with "floating" exchange rates and uncertainty.

Why this historical review of the transition from the classical (fractional-reserve) gold standard to today's sea of utterly irredeemable fiat currencies? To make two important points:

1. First, the traditional gold standard was not abandoned all at once in a single act. It was a step-by-step process of gradual demonetization of gold. As the editor of *Remnant Review*, Dr. Gary North, aptly put it in his issue for April 18, 1980: "Each successive step has been taken to 'make better use of our national gold reserves,' that is, to make fractional reserving easier, inflation easier. Gold's *official* role was rather like the famous Cheshire cat which confronted Alice: it faded away until only the smile was left. In 1971, Nixon removed even that."

2. Secondly, there is a lesson from America's experience with the fractional-reserve gold standard. If government has any control at all over a nation's money, it will expand that control until it abolishes market money (gold and silver), replacing it with its own fiat paper. Money under the control of a political monopoly either is, or is in the process of becoming, an irredeemable fiat currency. The natural movement of monopoly-controlled money is toward inflation.

Once the governmental camel was permitted to stick its nose into the monetary tent, it was only a matter of time before the incorrigible beast completely ruined the once-proud dollar. The dollar's link with gold was increasingly weakened, then completely abandoned, leaving us with the present national and international monetary muddle. Henry Hazlitt states the lesson well: "In sum, the belief that the creation and management of a monetary system ought to be the prerogative of the state — that is, of the politicians in power — is not only false but harmful. For the real solution is just the opposite. *It is to get government, as far as possible, out of the monetary sphere.*"

In contrast to the classical gold system, the Mises economists advocate as an "ideal" a system in which governments would be deprived of their monopoly over the currency-issuing power. Private citizens would be allowed to do business with one another in the currency or coin of their choice, foreign or domestic. They would also be allowed privately

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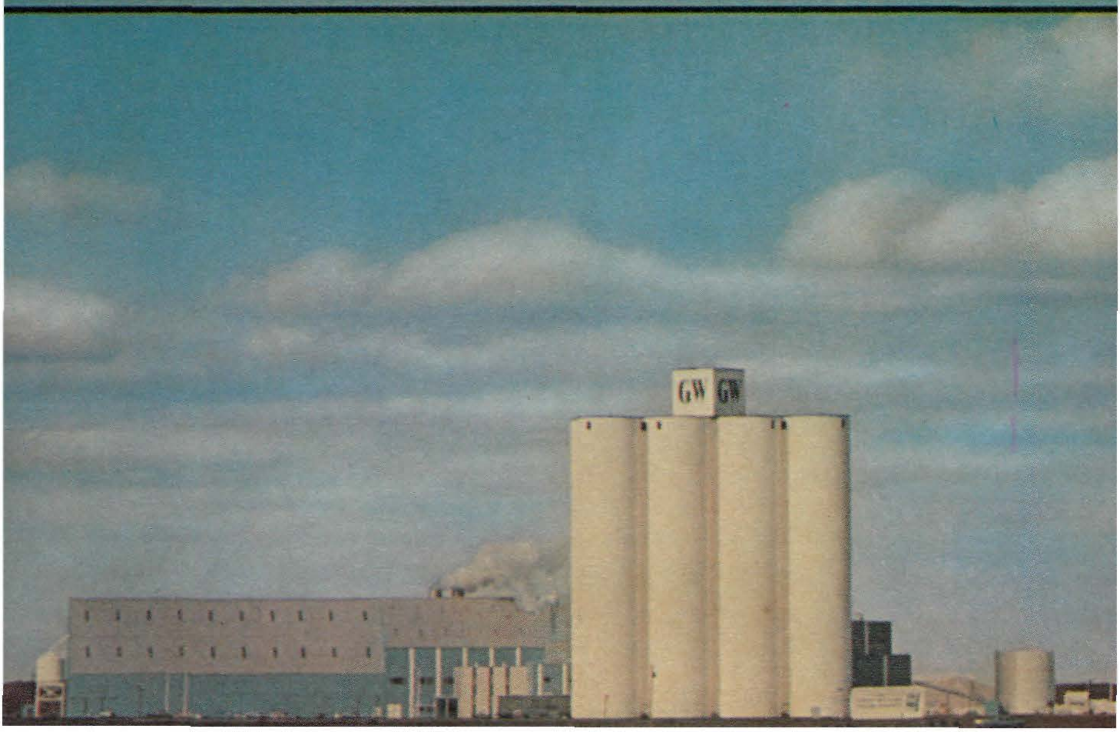


to mint gold and silver coins and do business in those coins. Although each coin would bear the stamp, trademark, or emblem of its minter, it would be preferable if they were referred to by their round weight — a "gold gram" or a "silver ounce" — rather than by an abstract name. This freedom of choice in money would develop into a market gold standard, with little or no fractional reserving — thus avoiding the credit-expansion cycles of boom and bust.

In contrast to this are the more widely publicized proposals of various supply-side activists for a return to some form of fractional gold standard. Under a plan advocated by economist Arthur Laffer, for example, the Fed would have to try to maintain a target reserve of gold equal to forty percent of the basic money supply. However, the government would have the power to suspend its trading in gold whenever gold reserves fell below twenty-five percent due to continued inflation. When this occurs, says Laffer, "The dollar's convertibility will be temporarily suspended and the dollar price of gold will be set free for a three-month adjustment period."

This trial-and-error approach is not likely to be an effective control over the inflationary tendencies of Big Government and the monetary authorities of the Fed. Nor is it likely to instill confidence in the system to bring down interest rates. Critics argue that, in practice, Laffer's plan would be a warmed-over version of the old gold-exchange system as extended by the Bretton Woods meeting.* It would not last very long, and its failure could wrongly discredit the idea of a true gold standard.

Then there is the more hard-core position taken by Lewis Lehrman, a highly successful East Coast entrepreneur and articulate pro-gold spokesman. Creator of a national pharmaceutical chain, Lehrman's prescription for our economic ills involves a strong dose of supply-side economic policies and the re-establishment of the classical gold standard, with people using gold coins as part of their everyday money and cash holdings. The Lehrman Institute, a New York-based think tank he founded in 1977, has sponsored many important studies concerning gold, and also provides much intellectual ammunition to supply-siders within the Reagan Administration for use in their factional battles with the anti-gold monetarists who now dominate the Treasury. Whether the U.S even tries to go to a gold standard will probably depend on Lehrman.

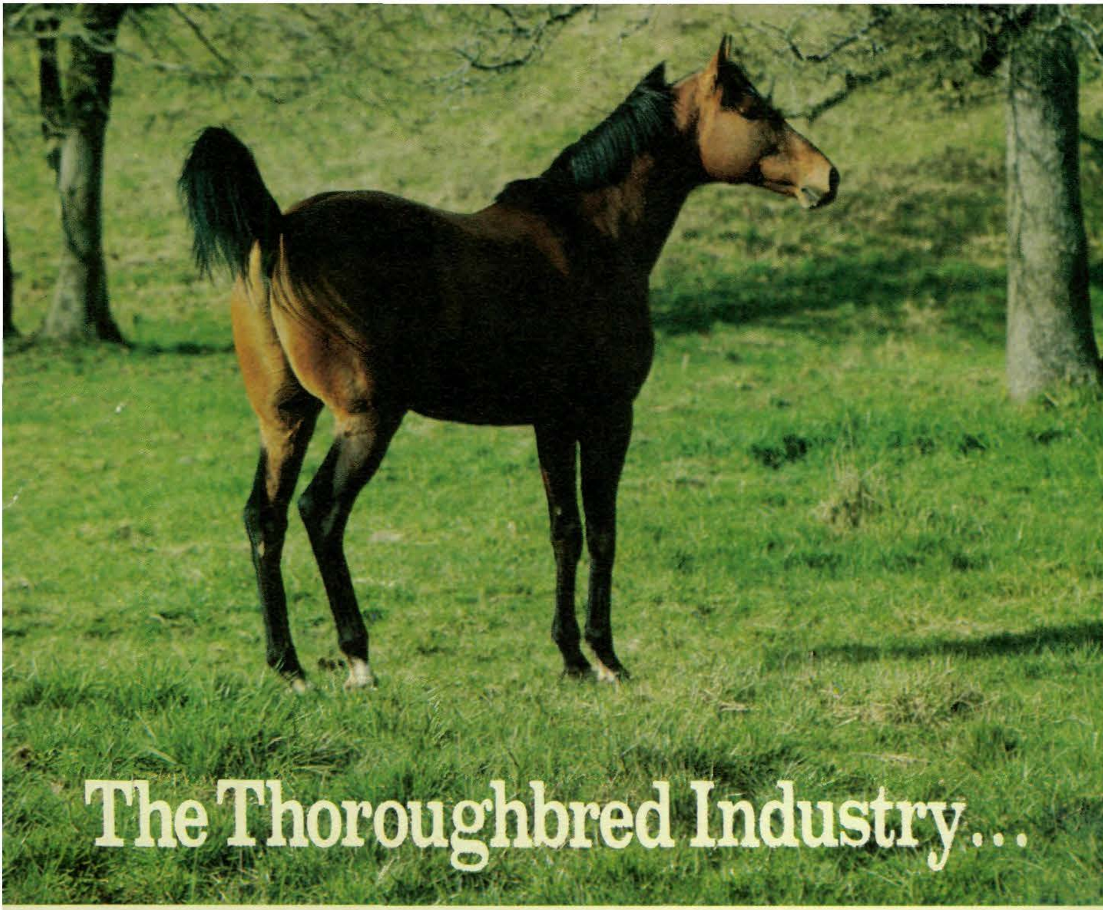
Summarizing our basic monetary alternatives, we have the following:

1. Under a fiat money system, with fractional-reserve banking, "managed" by governments or central banks, the money supply is inflatable without limit (especially now with the Monetary Control Act of 1980). This is what we have now.

2. Under a partial gold standard, with fractional-reserve banking, the money supply is inflatable within known but arbitrary limits (depending on the reserve ratio at any given time). This institutionalizes limited inflation and brings about cycles of boom and slump. That is what we had in the classical gold standard.

3. Under a full gold standard, with honest banking, the money supply is fixed, except for inconsequential amounts (less than two percent annually of total stocks) added by mining. Widespread inflation and deflation are not possible. This is what Mises advocated.

*For a detailed critique of the Laffer plan, see Henry Hazlitt's "Gold Prospects," published in the Spring 1981 issue of *Policy Review*, a journal of the Heritage Foundation.



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But if this last proposal is controversial — even among advocates of a Free Market and a gold standard — there is even greater conflict when it comes to how to convert from our present paper chase. The most comprehensive plan pending in Congress to convert our present debt-reserve paper arrangement into a Free Market gold system is the Monetary Freedom Act introduced by Representative Ron Paul of Texas. In a step-by-step process which would include a full audit and assay of the nation's gold stock, this act would repeal all legal-tender laws, make Federal Reserve notes redeemable in gold for a limited period, and finally sever completely any connection between politics and money.*

But there is still the sticky question of the weight in gold at which dollar convertibility should be made. According to Professor Rothbard, there are basically two ways to go to a one hundred percent gold system. He states: "One is to set gold at whatever the market price is at the moment, abolish the Fed (of course), and then there could be a deflation in which the banks would be smashed. You could get down to a one hundred percent system that way.

"The other way to do it is simply to start off with the current money supply and set the price of gold at whatever level it would have to be to cover the total money supply, and then make it one hundred percent. I favor this as it involves the least problems. The only thing wrong with it is that the banks would be getting a gift which they really don't deserve; in other words, the banks would suddenly find themselves in a one hundred percent reserve situation. But, while I recognize this problem, I sort of feel — well, the heck with them — it's true they're a bunch of S.O.B.s, but instead of putting the country through a deflation which is really unnecessary, we could start at ground zero and do that anyway. While it would, in effect, be letting the bankers off the hook, the gift would be absolved by the fact that they wouldn't be able to expand any money on top of it."

In a similar vein, Professor Reisman argues that the critical factor in a transition to sound money is how to avoid a painful contraction of spending and revenues in the private sector following the cessation of inflation. He maintains that this could be accomplished by the adoption of a one hundred percent gold coin standard at *an appropriately high price for gold*. That is, it would be possible, he states, "to stop inflation cold with one hundred percent gold money, and simultaneously offset the fall in the velocity of circulation of money by making the gold supply equal to enough dollars to leave spending in terms of dollars unchanged."

To bring this about, the government would take its present gold stock of about 265 million ounces (assuming it still has the gold) and price it high enough to make it more than equal to the prevailing money supply, which is now a little over $400 billion. Reisman asserts that, "A price of about $1,500 an ounce would make the gold stock equal to the money supply. But I would think that people would want to hold gold much more tightly than paper money. So, the velocity of circulation would drop. To offset this extreme increase in the desire to own money, I came up with a price of $4,700 — neglecting foreign countries. When you take foreign countries into consideration, however, we would import a lot of

*See Dr. Paul's recent book *Gold, Peace, and Prosperity*, available at $5.00 from the Foundation for Rational Economics and Education, Inc., Box 1776, Lake Jackson, Texas 77566.

gold, so we wouldn't need a price of $4,700 — but rather, I figured, a price of perhaps $2,500 an ounce."*

The government would call in all paper currency and exchange newly minted gold coins for paper at the above ratio. Thereafter, the government would not even have to continue to mint coins, since that could be turned over to private firms under the Free Market. The rest of the gold would be used to place our banks on a one hundred percent reserve basis against their checking deposits.†

More likely, America will not embrace a one hundred percent system of gold and silver money as a formal policy of government in time to prevent serious economic catastrophe. In the meantime we will see people turning to gold and silver coins on their own to escape some of the effects of the ever-inflationary dollar economy. Already barter and the use of precious-metal money is developing into a full-fledged alternative economy — an "underground economy" — separate from dollar-denominated exchanges which suffer the ravages of inflation and taxation. This process will accelerate, despite legal-tender laws, should the dollar near the verge of collapse. Panic buying will push precious-metals prices to astronomical heights. And Establishment *Insiders* will try to take advantage of this to buy up the nation's assets.

The coming re-emergence of gold as money could be eased, however, and greatly expedited, if Americans had real freedom to use gold coins on an equal footing with Federal Reserve notes, and if we could get at least some of the gold out of the hands of the government and the international bankers and into the hands of the people.

While it is probably unrealistic to expect to see the repeal of all legal-tender laws and complete freedom of choice in the election of what to use as money, it is possible that — with enough popular support — limited freedom of choice between gold and paper dollars could be achieved in time to prevent total disaster. Such a reform is embodied in H.R. 3789, the Free Market Coinage Act introduced by Representative Dan Crane (R.-Illinois). This bill provides for the minting of gold coins. It would also recognize the freedom to use gold as money and to make contracts in terms of gold. This, hopefully, will be one of the reforms that the U.S. Gold Commission will take under serious consideration.

Unfortunately, the Commission is a deck heavily stacked in favor of anti-gold, anti-choice types. Out of its seventeen members, only four are now in favor of some form of gold standard. The group is dominated by the Treasury monetarists who will be anxious to see to it that the Commission doesn't make waves. It doesn't take a gypsy with a crystal ball to predict that any gold standard we get in the foreseeable future will be a *managed* standard if we get one at all. And that management is a thing to fear. ■ ■

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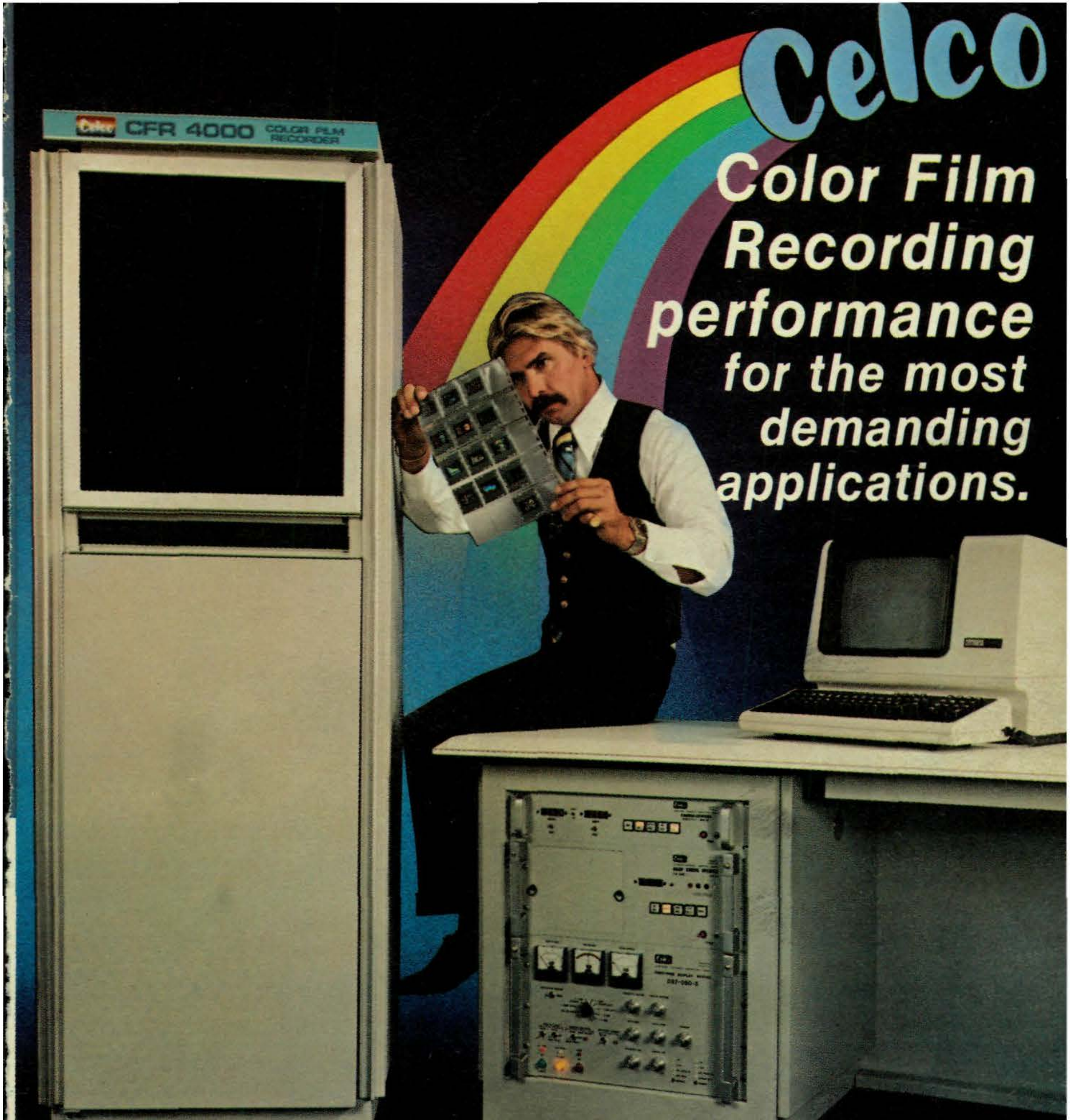
*Reisman points out: "This is not a 'fixing' of price. This is putting the dollar on a standard. If you want to have a Free Market in money, and you didn't want to make the dollar convertible to gold at any fixed price whatever, the dollar would be totally destroyed. All debt obligations would be worthless. So, this is salvaging some of the value of assets, *etc.*, stated in dollars."

†It should be pointed out that, while gold would be the main element in such a system, silver coins would also have to play a substantial role alongside gold in order to take care of smaller transactions (because the smallest practical size gold coin would have too much purchasing power for many everyday purchases). The exchange ratio between silver and gold, however, would not be fixed by law since this would bring Gresham's Law into play.



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